

Looking for something to read? See our [Reading List](#); these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

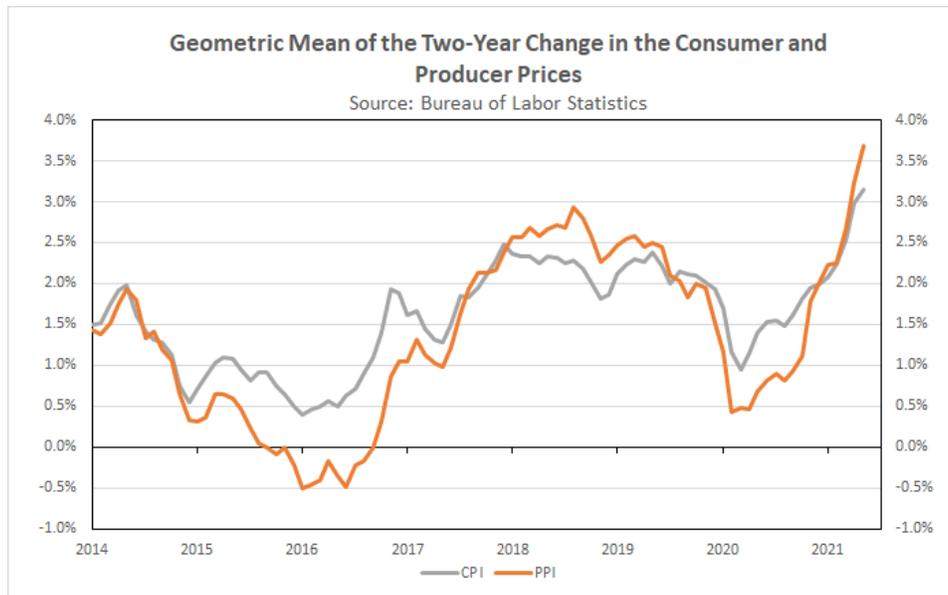
**[Posted: August 13, 2021—9:30 AM EDT]** Global equity markets are mixed this morning. In Europe, the EuroStoxx 50 is up 0.2% from its prior close. In Asia, the MSCI Asia Apex 50 closed down 1.0%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its prior close and the Shenzhen Composite also down 0.4%. U.S. equity index futures are signaling a higher open. With 456 companies having reported, the S&P 500 Q2 2021 earnings stand at \$52.30, higher than the \$45.31 forecast for the quarter. The forecast reflects a 60.0% increase from Q2 2020 earnings. Thus far this quarter, 86.2% of the companies have reported earnings above forecast, while 12.1% have reported earnings below forecast.

The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Weekly Geopolitical Report](#) (8/9/2021): “August 15, 1971”
- [Weekly Energy Update](#) (8/12/2021): We cover the administration’s curious call for more OPEC+ oil
- [Asset Allocation Q2 2021 Rebalance Presentation](#) (5/20/2021): A video discussion of our asset allocation process, portfolio changes in Q2, and the macro environment
- **[Asset Allocation Weekly](#) (8/13/2021) (with associated [podcast](#) and [chart book](#)): we focus on the implications of growing intellectual property investment**
- [Confluence of Ideas podcast](#) (7/7/2021): “The Geopolitics of Taiwan and the Issue of Globalization”

Good morning, all! U.S. equities appear to be headed for a higher open this morning. Our report begins with a discussion about inflation. Next, we provide a round-up of international news, including the Taliban's advancement in Afghanistan and Bolsonaro's attempt to undermine the electoral process in Brazil. U.S. economics and policy news are up next, including details about the latest Census survey. China news follows, and we end with our pandemic coverage.

**Let’s talk about CPI:** The Bureau of Labor Statistics released the latest price figures this week and it offered some reassuring news. The month-over-month rise in CPI decelerated to its slowest pace in five months. In July, headline CPI rose 0.5%, down from the previous month's reading of 0.9%. Additionally, core CPI slowed from 0.9% in June to 0.3% in the latest report. The deceleration was led by a steep decline in the pace of price increases for used cars. The report showed that the rise in used car prices slowed from 10.5% in June to 0.2% in the following month. Despite the moderation in CPI, inflation fears may still be warranted.



The chart above shows the geometric mean of the two-year change in the producer and consumer price indexes. This chart is designed to improve the year-over-year comparability of the indexes by averaging the change over the last two years, thereby limiting the pandemic distortions. That being said, the data suggests that despite the moderation in consumer prices in July, price pressures are still building throughout the economy. At this time, it appears that this pressure may be related to a lack of inventory. As a result of material shortages, demand for goods and services remains high as firms attempt to rebuild their inventories to meet growing demand. As of June, retail inventories for motor vehicles and clothes are still well below their pre-pandemic levels, while sales appear to be very strong. Over time, we believe as production capacity expands inventories will return to their normal level and this should relieve the economy of some inflationary pressure. Therefore, the most recent report has not changed our view that inflation is likely transitory.

#### International news:

- The Venezuelan government and its opposition [will meet in Mexico City on Friday to discuss how to resolve their differences](#). The discussion will be mediated by international observers such as Norway. At this time, there are no expectations of a breakthrough.
- On Sunday, Canadian Prime Minister Justin Trudeau [is expected to announce a snap election on September 20](#) as he attempts to gain approval for his COVID-19 response. PM Trudeau is currently working with a minority government and relies on smaller parties to get legislation passed.
- Brazilian Supreme Court Justice Alexandre de Moraes [opened a probe into President Jair Bolsonaro for posting documents from a sealed investigation](#). Bolsonaro has been trying to undermine the integrity of the election as he remains widely unpopular within the country. The documents that he posted were related to an investigation into the hacking of a federal election court. Over the last few months, he has been spreading unsubstantiated claims about election machines being targeted by foreign hackers. Bolsonaro's behavior suggests that he may not accept the results of the election if he

were to lose. Given the country's history and Bolsonaro's recent [comments](#), we would not be surprised to see another military takeover in Brazil following the election. In this event, it would likely be very bad for Brazilian equities as Brazil would be hit by sanctions from the U.S. and Europe. However, in the long run we think conditions could become more favorable for stocks.

- The Taliban has edged closer to taking over the country of Afghanistan. The rebel group has taken several major cities throughout the country at a much faster pace than originally anticipated. On Thursday, it [took control of its 10th provincial capital](#) as it edges closer to surrounding Kabul, the capital of Afghanistan. In response to the Taliban's advancement, EU Foreign Policy Chief Josep Borrell suggested that the [Afghan government should attempt to reach a settlement](#) with the group. The U.S. and U.K. have [deployed troops in Afghanistan in order to expedite the evacuation of staff](#) from embassies within Kabul.

### **Economics and policy:**

- Details from [the latest Census survey](#) were released on Thursday. Here are a few takeaways from the report:
  - Over the last decade, the population grew 7.4%, the slowest pace since the Great Depression.
  - For the first time in history, the number of people who identify as White decreased.
  - People identifying as being more than one race were the fastest growing group. This change was partially due to adjustments made by the Census Bureau.
  - Additionally, almost half of the country's children are nonwhite, suggesting the country will become more diverse over time.
  - Lastly, it appears more people have left rural areas in favor of cities. The change in demographics may have an impact on the makeup of Congress. An increase in urbanization generally favors Republicans' ability to win more seats in the Senate.
- Bill Gates announced that a fund run by his investment firm [will commit \\$1.5 billion to the Department of Energy](#) if Congress enacts a program aimed at developing technologies that cut carbon emissions. The initiative is meant to attract other investors to raise an additional \$15 billion.
- [Home prices have risen in almost every part of the country](#) according to the National Association of Realtors. The rise in home prices has likely been spurred by low interest rates.
- The Supreme Court [lifted a ban on New York State's eviction moratorium](#) as litigation over the dispute continues.

### **China:**

- Several provincial cities in China have [declared a red alert following floods](#) throughout the country.
- The population in Hong Kong [declined at its fastest pace ever in 2020](#) as many people left the region following the passage of the national security law.

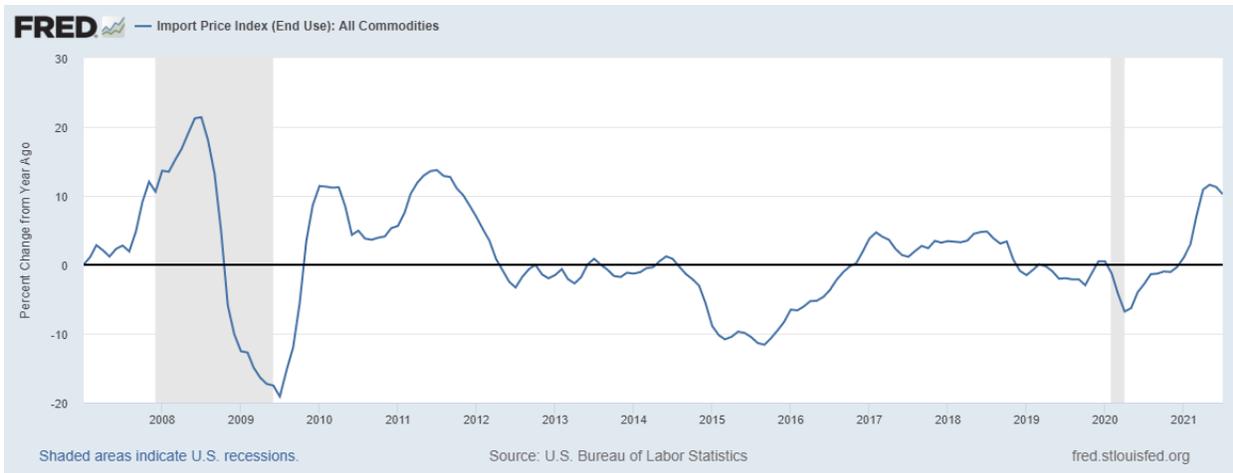
- A combination of the pandemic and worsening U.S./China relations have made [Chinese students more hesitant to study at American universities](#).

**COVID-19:** The [number of reported cases](#) is 205,462,557 with 4,335,111 fatalities. In the U.S., there are 36,306,917 confirmed cases with 619,093 deaths. For illustration purposes, the *FT* has created an [interactive chart](#) that allows one to compare cases across nations using similar scaling metrics. The *FT* has also issued an [economic tracker](#) that looks across countries with high-frequency data on various factors. The [CDC reports](#) that 411,253,925 doses of the vaccine have been distributed with 353,859,894 doses injected. The number receiving at least one dose is 196,505,543, while the number receiving second doses, which would grant the highest level of immunity, is 167,354,729. The *FT* has a page on [global vaccine distribution](#).

- On Thursday, Supreme Court Justice Amy Coney Barrett [turned down a challenge to Indiana University's vaccine mandate](#). The school requires that all students be vaccinated unless they have a religious or medical exemption. Students who are not vaccinated would have to submit to testing. The students that sued the school in order to block the mandate argued that it violated their constitutional rights. This was the first vaccine mandate-related suit to be turned down by the Supreme Court.
- The Food and Drug Administration expanded [the emergency use of the COVID-19 vaccine to include a third dose](#) for certain immunocompromised people. Although the third dose has yet to be expanded to the broader population, the country's leading infectious expert, Dr. Anthony Fauci, stated that people will [eventually need to receive the third dose](#).
- Rising COVID-19 cases in China [have led to a closure of shipping ports at the Yantian Port and Ningbo-Zhoushan Port](#). The port closures could exacerbate price pressures as it will be harder for firms to maintain inventories.
- More job postings are [requiring applicants to be vaccinated](#). The push for vaccination highlights growing fears about the spread of the delta variant.

## U.S. Economic Releases

In the only significant U.S. release so far this morning, July import prices rose by a seasonally adjusted 0.3%, far better than the expected rise of 0.6% and the June increase of 1.1%. Import prices excluding the volatile petroleum category were up just 0.1% compared with their anticipated rise of 0.5% and their June increase of 0.7%. The relatively moderate increases in July could help ease concerns about high inflation persisting into the future, although it's important to remember that prices have still increased quite a bit from the depths of the pandemic one year ago. Overall, import prices in July were up 10.2% year-over-year. The chart below shows the year-over-year change in import prices since just prior to the previous recession.



The table below lists the economic releases scheduled for the rest of the day.

Economic Releases						
EDT	Indicator			Expected	Prior	Rating
10:00	U. of Michigan Consumer Sentiment	m/m	Aug P	81.2	81.2	***
10:00	U. of Michigan Current Conditions	m/m	Aug P	82.0	84.5	**
10:00	U. of Michigan Expectations	m/m	Aug P	77.5	79	**
10:00	U. of Michigan 1-Year Inflation Expectation	m/m	Aug P	4.6%	4.7%	*
10:00	U. of Michigan 5-10 Year Inflation Expectation	m/m	Aug P		2.8%	*
Fed Speakers or Events						
No Fed speakers or events today						

## Foreign Economic News

We monitor numerous global economic indicators on a continuous basis. The most significant international news that was released overnight is outlined below. Not all releases are equally significant, thus we have created a star rating to convey to our readers the importance of the various indicators. The rating column below is a three-star scale of importance, with one star being the least important and three stars being the most important. We note that these ratings do change over time as economic circumstances change. Additionally, for ease of reading, we have also color-coded the market impact section, which indicates the effect on the foreign market. Red indicates a concerning development, yellow indicates an emerging trend that we are following closely for possible complications, and green indicates neutral conditions. We will add a paragraph below if any development merits further explanation.

	Indicator			Current	Prior	Expected	Rating	Market Impact
<b>ASIA-PACIFIC</b>								
<b>Japan</b>	Japanese Purchases of Foreign Stocks	w/w	6-Aug	¥615.7b	-¥190.6b		*	Equity and bond neutral
	Japanese Purchases of Foreign Bonds	w/w	6-Aug	-¥1103.6b	¥225.6b		*	Equity and bond neutral
	Foreign Purchases of Japanese Stocks	w/w	6-Aug	¥104.9b	¥3.2b		*	Equity and bond neutral
	Foreign Purchases of Japanese Bonds	w/w	6-Aug	¥681.8b	¥547.8b		*	Equity and bond neutral
<b>New Zealand</b>	BusinessNZ Manufacturing PMI	y/y	Jul	62.6	60.9		***	Equity bullish, bond bearish
<b>South Korea</b>	Import Price Index	y/y	Jul	19.2%	14.4%		*	Equity and bond neutral
	Export Price Index	y/y	Jul	16.9%	13.0%		*	Equity and bond neutral
<b>China</b>	Foreign Direct Investment YTD	y/y	Jul	25.5%	28.7%		*	Equity and bond neutral
<b>India</b>	Industrial Production	y/y	Jun	13.6%	28.6%	14.0%	***	Equity bearish, bond bullish
	CPI	y/y	Jul	5.6%	6.3%	5.7%	**	Equity and bond neutral
<b>EUROPE</b>								
<b>Germany</b>	Wholesale Price Index	y/y	Jul	11.3%	10.7%		*	Equity and bond neutral
<b>France</b>	ILO Unemployment Rate	q/q	2Q	8.0%	8.1%	7.8%	*	Equity bearish, bond bullish
	CPI	y/y	Jul F	1.2%	1.2%	1.2%	***	Equity and bond neutral
	CPI EU Harmonized	y/y	Jul F	1.5%	1.6%	1.6%	**	Equity and bond neutral
<b>Switzerland</b>	Producer & Import Price Index	y/y	Jul	3.3%	2.9%	3.1%	**	Equity and bond neutral
<b>AMERICAS</b>								
<b>Brazil</b>	Economic Activity Index	y/y	Jun	9.1%	14.2%	8.9%	*	Equity bullish, bond bearish

## Financial Markets

The table below highlights some of the indicators that we follow on a daily basis. Again, the color coding is similar to the foreign news description above. We will add a paragraph below if a certain move merits further explanation.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	12	12	0	Down
3-mo T-bill yield (bps)	5	5	0	Neutral
TED spread (bps)	8	8	0	Neutral
U.S. Libor/OIS spread (bps)	9	9	0	Up
10-yr T-note (%)	1.34	1.36	-0.02	down
Euribor/OIS spread (bps)	-55	-55	0	Neutral
EUR/USD 3-mo swap (bps)	3	2	1	Down
Currencies	Direction			
dollar	Down			Down
euro	Up			Up
yen	Up			Up
pound	Up			Up
franc	Up			Up

## Commodity Markets

The commodity section below shows some of the commodity prices and their change from the prior trading day, with commentary on the cause of the change highlighted in the last column.

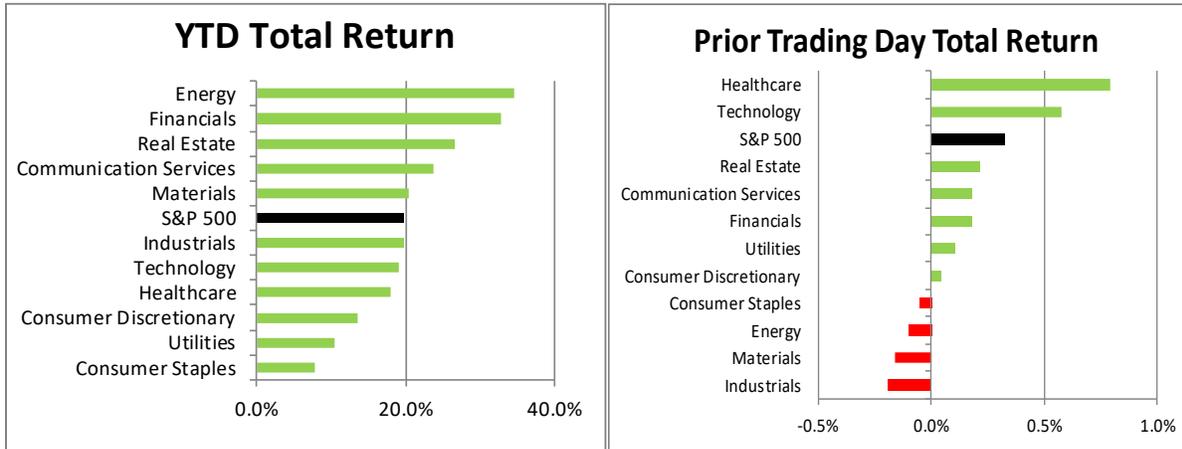
	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$71.26	\$71.31	-0.07%	
WTI	\$69.03	\$69.09	-0.09%	
Natural Gas	\$3.89	\$3.93	-1.09%	
Crack Spread	\$23.83	\$24.10	-1.12%	
12-mo strip crack	\$20.63	\$20.86	-1.09%	
Ethanol rack	\$2.43	\$2.42	0.40%	
<b>Metals</b>				
Gold	\$1,760.72	\$1,752.90	0.45%	
Silver	\$23.43	\$23.18	1.09%	
Copper contract	\$435.65	\$436.00	-0.08%	
<b>Grains</b>				
Corn contract	\$577.50	\$573.25	0.74%	
Wheat contract	\$777.50	\$764.75	1.67%	
Soybeans contract	\$1,356.00	\$1,341.00	1.12%	
<b>Shipping</b>				
Baltic Dry Freight	3,503	3,410	93	
<b>DOE inventory report</b>				
	<b>Actual</b>	<b>Expected</b>	<b>Difference</b>	
Crude (mb)	-0.4	-0.5	0.1	
Gasoline (mb)	-1.4	-2.0	0.6	
Distillates (mb)	1.8	-0.3	2.1	
Refinery run rates (%)	0.50%	0.30%	0.2%	
Natural gas (bcf)	49.0	47.0	2.0	

## Weather

The 6-10 day and 8-14 day forecasts currently call for cooler-than-normal temperatures throughout the Rocky Mountain region, with warmer-than-normal temperatures in the Midwest and Northeast. The forecast calls for wetter-than-normal conditions in the Great Plains and the South, with dry conditions concentrated in the Pacific Northwest, the Rocky Mountains, South Texas, and New England. Tropical Depression Fred is currently moving along the northern coast of Cuba and is expected to make its way to Florida over the weekend. There is also a disturbance off the coast of South America that is expected to become a cyclone in the coming days.

**Data Section**

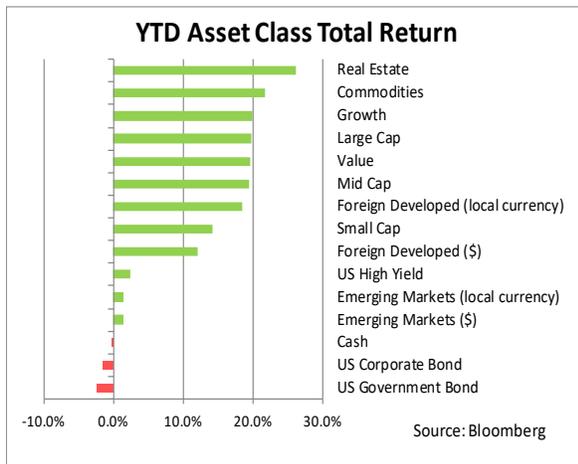
**U.S. Equity Markets – (as of 8/12/2021 close)**



(Source: Bloomberg)

These S&P 500 and sector return charts are designed to provide the reader with an easy overview of the year-to-date and prior trading day total return. Sectors are ranked by total return; green indicating positive and red indicating negative return, along with the overall S&P 500 in black. These charts represent the new sectors following the 2018 sector reconfiguration.

**Asset Class Performance – (as of 8/12/2021 close)**

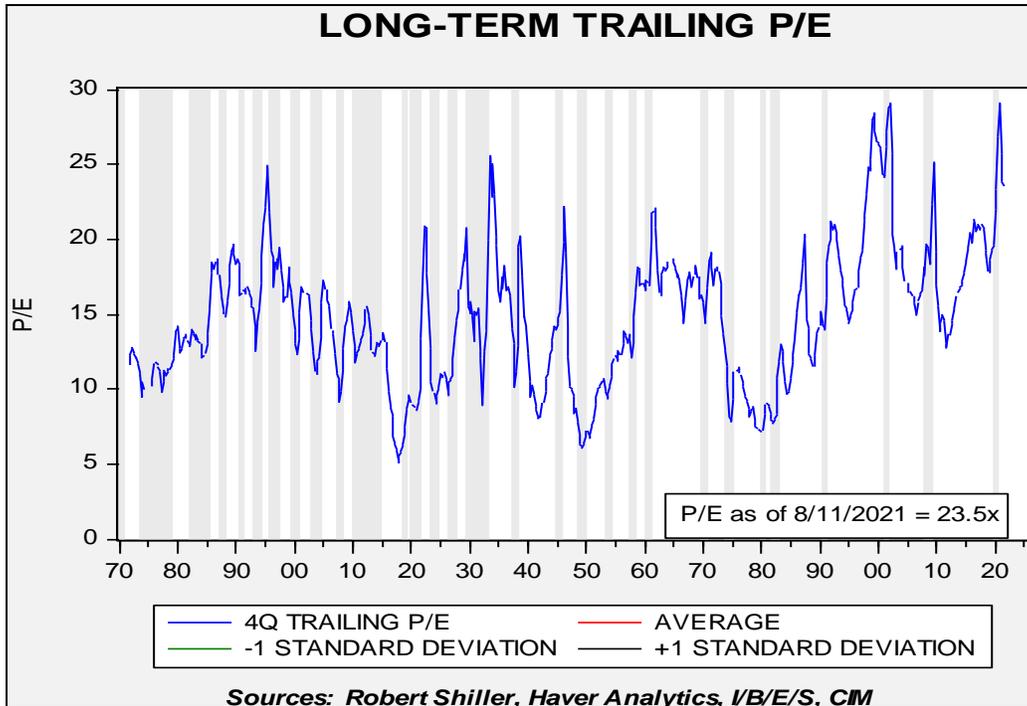


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

Asset classes are defined as follows: Large Cap (S&P 500 Index), Mid Cap (S&P 400 Index), Small Cap (Russell 2000 Index), Foreign Developed (MSCI EAFE (USD and local currency) Index), Real Estate (FTSE NAREIT Index), Emerging Markets (MSCI Emerging Markets (USD and local currency) Index), Cash (iShares Short Treasury Bond ETF), U.S. Corporate Bond (iShares iBoxx \$ Investment Grade Corporate Bond ETF), U.S. Government Bond (iShares 7-10 Year Treasury Bond ETF), U.S. High Yield (iShares iBoxx \$ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index), Value (S&P 500 Value), Growth (S&P 500 Growth).

## P/E Update

August 12, 2021



Based on our methodology,<sup>1</sup> the current P/E is 23.5x, down 0.6x from last week. Rising earnings and steady index values led to the decline in the multiple.

*This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.*

<sup>1</sup> This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the I/B/E/S estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q4 and Q1) and two estimates (Q2 and Q3). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.